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Agenda Item 6

August 15, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Interim Asset Allocation Targets

II. PROGRAM: Asset Allocation / Risk Management

III. RECOMMENDATION: Staff recommends approval of revised quarterly asset allocation targets

IV. ANALYSIS:

In December 2010, the Investment Committee (the Committee) approved a new asset classification and asset class policy targets and ranges. The statement of Investment Policy for Asset Allocation incorporating these changes was approved by the Committee in May 2011 and became effective July 1, 2011. The Committee also approved interim asset allocation targets for the period July 1, 2011 to June 30, 2012 (Attachment 1).

In this memo, staff is recommending the following changes to the interim quarterly asset allocation targets (Attachment 2):

1. Global Equity interim target is increased by 1% to 50% from Q3 2011 to Q4 2012.
2. Income [Global Fixed Income (GFI)] target is increased by 1% in Q3 and Q4 2011, then again by 1% in Q3 and Q4 2012.
3. Infrastructure/Forestland target is reduced from 3% to 2% in Q3 2012 and Q4 2012.
4. Real Estate interim target is reduced from 10% to 8% to match the current actual allocation of 7.8% in Q3 and Q4 of 2011 and then set at 9% in 2012.

These changes are being recommended primarily to accommodate a more gradual buildup of the real estate portfolio following the significant write downs taken in recent years which caused Real Estate to be underweight by as much as 3% relative to the 10% target.

As of June 30, 2011, the Real Estate market value was 7.8% of the Total Fund, while the value of the unfunded Real Estate commitments has continued to decline. The focus of the recently approved Real Estate Strategic plan is core income-generating commercial properties. However, strong demand for these properties continues to push their prices higher, making it difficult to identify core properties with attractive return-to-risk outlooks. This change would enable CalPERS to be a more patient Real Estate investor, better able to defer substantial new commitments until pricing is more favorable.

Total Fund expected risks and returns would be little affected by the revised target allocations. Based on the November 2010 Asset Liability Management Workshop capital market assumptions, the Total Fund expected annualized compound return would be 7.34%, 3 basis points below the 7.37% expected return of the current portfolio.

The proposed asset class targets are listed in Attachment 2. Opinion letters from Wilshire and PCA are included as Attachments 3 and 4.

V. STRATEGIC PLAN:

This item addresses Strategic Plan Goals VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions; and IX, achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

Approval of the revised policy targets would result in reduced costs, as the revised target allocations are more similar to current actual allocations.

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